RECEIVED
APR 13 1921
SUPREME COURT U. S.

Supreme Court of the United States

OCTOBER TERM, 1920.

No. 742.

JAMES J. WALSH, United States Collector of Internal Revenue for the District of Connecticut,

Plaintiff in Error.

v.

FREDERICK F. BREWSTER.

PETITION FOR REHEARING.

HENRY F. PARMELEE,
GEORGE D. WATROUS,
HENRY M. WARD,
BARRY MOHUN,
Of counsel for Defendant in Error.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1920.

No. 742.

JAMES J. WALSH, United States Collector of Internal Revenue for the District of Connecticut,

Plaintiff in Error,

v.

FREDERICK F. BREWSTER.

PETITION FOR REHEARING

Frederick F. Brewster, the defendant in error, by his counsel, prays for a rehearing of the above entitled cause.

The instant case, and the cases of *Merchant's Loan & Trust Company v. Smietanka*, No. 608, and *Eldorado Coal & Mining Company v. Mager*, No. 609, argued January 11th and 12th, and *Goodrich v. Edwards*, No. 663, argued with the instant case March 11th and 12th, were all decided on the same day, March 28th. The principal opinion was written in the *Merchant's Loan & Trust Company* case. All the questions involved were thereby decided in favor of the Government, with the exception of the question involved in the instant case and in the Goodrich case, namely as to whether when no profit has been realized, or a loss has been in fact sustained, upon the sale of property acquired before March 1, 1913, the Act of 1916 imposes a tax upon the difference between the market value on that date (it being lower than the value at the time of acquisition) and the price realized upon the sale. This question has been decided in favor of the taxpayers.

The defendant in error respectfully represents that a rehearing should be granted for the following reasons:

In the instant case counsel relied on the concession made by the Solicitor General in his brief in the *Merchant's Loan & Trust Company* case (p. 28) based on the ruling of this Court in *Lynch v. Turrish*, to the effect that under the Act of 1913 (38 Stat. 166) realized increment of value was not taxed. This concession was apparently overlooked by the Court for in the opinion in the *Merchant's Loan & Trust Company* case (p. 5) it is stated:

> "There can be no doubt that the word (income) must be given the same meaning and content in the Income Tax Acts of 1916 and 1917 that it had in the Act of 1913."

The concession of the Solicitor General referred to is as follows:

> "In *Lynch v. Turrish* the Act of 1913 was involved. That Act was unlike the Act of 1909 and like the Act of 1867 in that it imposed the tax upon the income *arising or accruing* during the year. The distinction drawn in the *Doyle* case, therefore, did not apply to the *Turrish* case, and *Gray v. Darlington* could very well be treated as authority in the latter case. In the Act of 1916, however, the language of the Act of 1913 is abandoned and Congress goes back to the Act of 1909 by imposing the tax on income received during the year."

In the brief of the Solicitor General in *Goodrich v. Edwards* submitted in the instant case as well, this concession is repeated as follows (p. 6):

"*Gray v. Darlington* (15 Wall. 63) is not applicable to the present controversy. This court held in *Hays v. Gauley Mountain Coal Co.* (247 U. S. 189) that it was not controlling in a case arising under the Act of 1909 because that act measured the tax by the income *received* during the taxable year. True in *Lynch v. Turrish* (247 U. S. 221), it was said that *Gray v. Darlington could not be distinguished from a case arising under the Act of* 1913 which levied a tax upon income *arising or accruing* during the taxable year. The present act, however, goes back to the language of the Act of 1909 and imposes the tax upon income received during the taxable year."

It is submitted that *Lynch v. Turrish* (247 U. S. 221) is a controlling authority upon the proposition that the construction of the Act of 1913 is identical with that of the Act of 1867 upon the point involved, namely, that realized increment of value is not income or included within the term "gains, profits and income derived from any source whatever", a term common to both the Act of 1867 and the Act of 1913.

Yet the Court in its opinion in *Merchant's Loan & Trust Company v. Smietanka*, says, at page 3:

"Plainly the gain we are considering was derived from the sale of personal property and very certainly the comprehensive last clause, 'gains, profits and income derived from any source whatever', must also include it, if the trustee was a 'taxable person' within the meaning of the Act when the assessment was made."

In both *Lynch v. Turrish* and *Lynch v. Hornby* (247 U. S. 339), the increment of value had accrued to the corporation prior to March 1, 1913. In both cases the cash dividend which was the subject matter of the tax imposed, was received by the stockholder after that date. In the *Turrish* case what the taxpayer received was a final dividend upon the liquidation of the corporation. Upon the authority of *Gray v. Darlington* this final dividend, though it clearly was a gain or profit (p. 228), was held to be "increase of capital and not subject to a tax as income". In the *Hornby* case the dividend was paid in the ordinary course of business and was held to be income and taxed under the Act of 1913, although it represented an increment of value accrued prior to "the time of the law" (247 U. S. 229).

Had the capital profit involved in the *Turrish* case been income or been included within the content of the term "gains, profits and income derived from any source whatever" it must under *Lynch v. Hornby* and *Brushaber v. Union Pacific Ry. Co.*, have been taxed under the Act of 1913.

In *Lynch v. Hornby* there was no growth or increment of value after March 1, 1913, but all before that date. The cash dividend based on such increment of value was paid by a going corporation and was, therefore, income in the well understood and established meaning of the word. In *Lynch v. Turrish* the stockholder received a final dividend in liquidation which was held not taxable under the terms of the Act of 1913 because on the authority of *Gray v. Darlington* it was capital and not income.

It is further submitted that while under the departmental practice for some years income tax has been

imposed with respect to realized increment of value, this construction of the Act of 1913 was held by this court in the year 1918 (*Lynch v. Turrish*) to have been erroneous; that a similar construction of the Act of 1867 amending the Act of 1864 was held by this court in the year 1872 to have been erroneous (*Gray v. Darlington*); that no similar question had arisen or could have arisen with respect to the Act of 1894 at the time that Pollock brought his suit to enjoin the Farmers' Loan and Trust Company from paying income tax upon rents from real estate and interest and dividends from securities, that Turrish raised the point in 1914 (247 U. S. at 222) and finally that the plaintiff in error in the instant case raised the point before the Commissioner in 1917, when he made his return and that he has prosecuted this contention and asserted his claim of constitutional right with the greatest diligence and utmost expedition.

It is submitted there is no authority for the proposition that weight is to be given to an administrative construction of an act in direct conflict with the judicial construction given to the same language in a prior act, and that even before the enactment of the Act of 1916 the very point here involved had been raised by Turrish with respect to the construction of the Act of 1913.

It is further submitted that the British income tax decisions were cited, not as authorities upon the construction of the terms of the Act of 1916 but as showing a long and well established judicial definition of the word "income" as exclusive of capital, and a continuous ruling that realized increment of value is intrinsically capital, not income, hence as bearing upon the meaning of the word income when used in the Sixteenth Amendment (the meaning of which cannot be extended by

Statutory Enactment) as well as in the income tax laws. In like manner the decisions of all the highest courts of all the states which have passed upon the point, holding that profits realized upon the sale of investments of trust funds are capital, not income, were cited, not as relevant to the terms of the Act of 1916, but as showing beyond all controversy that from 1909 when the Amendment was proposed until 1913, when it was adopted, there was complete unanimity of judicial decision in holding that realized increment of value is capital, not income. In these cases there are not various rules adopted in various jurisdictions (as there are with respect to stock dividends) but one universal rule of decision holding realized increment of value to be capital.

Moreover in the cases on life tenant and remainderman, as in *Gray v. Darlington* and *Lynch v. Turrish*, and as in all the British income tax cases, the question involved was as to whether realized increment of value is inherently income or capital, just as in *Gibbons v. Mahon*, *Towne v. Eisner* and *Eisner v. Macomber* it was whether a stock dividend is the one or the other.

It is submitted that a construction of the word "income" as used in an income tax law adopted by this court for the first time in 1920 and never adopted by any court, before the proposal and adoption of the Sixteenth Amendment, or the enactment of the Act of 1916, cannot properly be said, in view of the unanimous rulings to the contrary, to define the meaning of the word in common usage at the time the Amendment was proposed and adopted.

It is submitted that all the cases arising under the Corporation Excise Tax Act of 1909 involved business

transactions, sales which were made through the exercise of the privilege of doing business in corporate form, upon which privilege the tax was imposed; that "income" as has been repeatedly pointed out did not necessarily have the same meaning in that act as in the amendment or in an income tax law. The decision in the case at bar, read in connection with *Lynch v. Hornby*, gives to Congress the power to tax at a graduated rate as income in the year of realization by sale, the increment of value in capital investments however long the period of accrual. The limitation of the period of accrual, so as not to antedate March 1, 1913, is a mere act of grace on the part of the legislature, and now in 1921 the accrual period has grown to eight years. It might as well be fifty years or a century.

It is submitted that there is a clear and fundamental distinction between profits realized from the sale of property in the course of business and the increment of value in property held as an investment of capital, realized through the sale of such property. The distinction relied on does not depend, as has been intimated in the opinion (page 6), on

> "whether the sale or conversion be a single isolated transaction or one of many"

but on whether the transaction is in the course of business or trade on the one hand or is a conversion of capital on the other. Though there be but one transaction, if it be a sale in the course of business, the profit will be income, conversely there may be a series of transactions each constituting a sale or conversion of capital assets, where no income will accrue but the entire proceeds will be capital.

The true distinction, it is submitted, is that realized increment is inherently capital, not taxable as income, where it is the result of a gradual growth or appreciation of value in the property itself, entirely apart from, and independent of, any act of the owner with respect to such property, or, to express the same thought in a concise phrase, where it is "unearned increment." On the other hand, a gain, or profit, realized from the sale or conversion of property, is inherently income where the owner or seller of the property has himself, through his acts with respect to the property, his mental and physical efforts and work, brought about the result of selling the property at more than he paid for it, but where the increment in value in the property itself, if any, is not an essential or controlling element in determining the fact of the realization of a profit. In the one case the gradual increment of value is, generally speaking, the sole cause in the realization of a "profit". In the other, increment of value is, in most instances, if not in all, merely incidental, but one partly contributing element, and an element of minor importance, in determining whether, on the whole, the business, trade, or speculation, shows a profit or a loss. In the case of a sale in the course of business a net profit, constituting an item of taxable income, may, and indeed generally does, arise even where there has been no increment of value in the property itself, considered apart from the value of the work that has been done with respect to it. The inherent value of the property itself considered apart from the work that has been done with respect to it may even be less at the time of sale than at the time of acquisition, yet, by reason of the work done, a business profit may be realized.

It is further submitted that there should be no apprehension that the construction of the Amendment and of the law advocated "would in a large measure defeat the purpose of the Amendment". (Opinion p. 7.)

The object and scope of the Amendment have been clearly defined. The contention has been earnestly pressed that the words "from whatever source derived" empowered Congress to tax the salaries of the Federal judges and of the President and of officers of the States. This construction has been definitely and finally rejected. (*Brushaber v. Union Pacific Ry. Co.*, 240 U. S. 1; *Evans v. Gore*, 253 U. S. 245; *Eisner v. Macomber*, 252 U. S. 189.)

Rents from real estate and income from invested property were not capital before the Amendment and income after its adoption. The Pollock case held that in substance and effect a tax on such rents and income was a tax upon the capital from which they were derived. The effect of the Amendment is not to transmute what before was capital into income, but to forbid an inquiry into the source of the income. Capital must still be taxed by the rule of apportionment, and the use of the word "incomes" rather than the term "gains, profits and income" indicates beyond controversy that no extension of the meaning and content of the word income was intended.

The distinction is the same as that between the capital assets of a corporation and its stock in trade. A corporation upon a profitable sale of its capital assets does not increase its earnings or income nor conversely upon the profitable sale of its stock in trade does it increase its capital assets. The distinction is perhaps

more emphatic in the case of a corporation for the law requires a separation between the capital and earnings of a corporation. But the same principle applies equally to individuals; the investments of an individual are his capital.

It is further submitted that the Court may have overlooked the debates in Congress at the time that the Sixteenth Amendment was proposed and at the times when the Acts of 1913, 1916 and 1919 were before the Senate and House of Representatives. The debates upon the amendment are referred to in the brief filed by Senators Smith and Gore as *amici curiae* (pages 12, 15, 16, 24 and 30.) The debates on the Acts of 1913 and 1916 are quoted in the appendix to the brief in *Goodrich v. Edwards*, No. 663. These debates clearly show that it was not the intention of Congress, either in the Amendment or any one of these Acts, to include realized capital increment as an item of taxable income.

For the reasons above stated the request for a re-argument is respectfully submitted.

HENRY F. PARMELEE,
GEORGE D. WATROUS,
HENRY M. WARD,
BARRY MOHUN,
Of counsel for Defendant in Error.

We hereby certify that in our opinion the above petition is well founded.
Henry F. Parmelee.
George D. Watrous.
Henry M. Ward.
Barry Mohun.